Internal Revenue Service

memorandum

CC:TL-N-6565-88
JCAlbro

date: AUG 15 1988

to: Utility Industry Counsel CC:CLE

from: Director, Tax Litigation Division CC:TL

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subject: [redacted] Project

This is in response to the requests for technical advice dated May 27 and June 20, 1988.

ISSUES

1. Where joint venturers have elected out of subchapter K treatment, who may make the section 195 election, the partnership or the individual partners? 0761-0104; 0195-0000.

2. When does an active trade or business begin for purposes of amortization under I.R.C. § 195? Is the placed in service date of a nuclear unit or the regulatory commercialization date relevant to this determination? 0195-0000.

3. Where a partnership has not elected out of subchapter K and has not elected to amortize start-up expenditures pursuant to section 195, may the limited partners elect section 195 amortization of such costs? 0195-0000.

CONCLUSIONS

1. Individual partners may make the section 195 election when the partnership has elected out of subchapter K.

2. The beginning of an active trade or business is a factual determination. The beginning of a partnership formed to operate a power plant occurs subsequent to the issuance of an operating license when the plant is in a state of readiness to be placed in service within a reasonable time.

3. Limited partners may not elect section 195 amortization of partnership start-up expenditures.

FACTS

Several questions have arisen with respect to the examinations of the joint venturers ([redacted]) who own and operate the [redacted]. The utility partners have elected out of subchapter K, pursuant to section 761 and the legal issues pertain to section 195 start-up expenditures in the context of the election out of subchapter K. In addition, a section 195 question has been raised in the Atlanta District involving limited partnerships in which [redacted] or subsidiaries are the general partners.

Section 761(a) provides that the Secretary may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of the subchapter K partnership provisions if it is availed of -

(1) for investment purposes only and not for the active conduct of a business,

(2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted... if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

A properly executed partnership return (Form 1065) must be timely filed for the first taxable year for which the exclusion is sought, and the election statement must be attached to or incorporated in the Form 1065. The return should contain only the name and address of the organization and information required for the election statement pursuant to Treas. Reg. § 1.761-2(b)(2)(i). A partner in an organization that has made a section 761(a) election generally computes income and deductions separately for the partner's interest in the partnership.

Section 195, Start-Up Expenditures, was added to the Code by P.L. 96-605, The Miscellaneous Revenue Act of 1980. Certain clarifying amendments were made to the section in the Tax Reform Act of 1984. The amendments do not affect the analysis herein. As presently enacted section 195 provides that:

(a) Capitalization of Expenditures - Except as otherwise provided in this section, no deduction shall be allowed for start-up expenditures.

(b) Election to Amortize -
(1) In general - Start-up expenditures may, at the election of the taxpayer, be treated as deferred expenses. Such deferred expenses shall be allowed as a deduction prorated equally over such period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the active trade or business begins).1/

The election must be made not later than the time for filing the return for the taxable year in which the trade or business begins (including extensions) § 195(d).

The facts regarding issue three are as follows. [redacted] or subsidiaries are general partners in various limited partnerships. The Corporate limited partners are reimbursing the general partner for start-up costs and on their corporate returns claiming amortization of the start-up costs under section 195.

The start-up costs are paid by the limited partner taxpayers as a result of written requests from general partners for reimbursement of pre-partnership or pre-operational expenses, which were incurred and paid by the general partner and reimbursable pursuant to section 4.2 of the partnership agreements. The reimbursement requests ask the limited partners to make the checks payable to the general partner. In the same request, capital contributions are to be payable to the partnership.

Section 4.2 of the partnership agreements refer to reimbursement of certain operating and management expenses incurred by the general partner on behalf of the partnership, after [redacted], a date which is two years prior to when business began for the partnerships and thus comports with such costs being "pre-operational expenses." The partnership agreements provide that the partnerships not the limited partners are to reimburse the general partner.

Start-up costs incurred by the general partner in preparation for the partnerships beginning operations include such costs as marketing, maintenance, facilities engineering, legal, accounting and auditing fees and development and implementation of billing procedures.

1/ In 1984, the word "active" was added. The Committee report on changes to section 195 did not discuss the reason for the change. We view the analysis herein as applicable regardless of the addition of the word active, subject of course to clarification in regulations. We do not believe that the use of active trade or business equates with a placed in service or commercialization date for a power plant in light of case law under sections 248 and 709 regarding when a trade or business begins.

The section 195 election statements attached to the limited partner taxpayers' corporate returns state: "A schedule to be attached to and made part of the U.S. partnership return of income.

DISCUSSION

It is our understanding that the utility/participants own and operate the [redacted] as joint venturers and are subject to the exclusion from subchapter K provision regarding operating agreements. Participants under operating agreements for the joint production, extraction, or use of property qualify for the election if they (a) own the property as co-owners in fee or by a lease or other contract granting exclusive operating rights; (b) reserve the right separately to take or dispose of their shares of any property produced, extracted, or used; and (c) do not jointly sell services or the property produced or extracted (although each separate participant may delegate authority to sell his share for a period not in excess of the minimum needs of the industry, and in no event for more than one year.) Treas. Reg. § 1.761-2(a)(3). In Rev. Rul. 68-344, 1968-1 C.B. 569, the Service ruled that this provision is not limited to operating agreements in connection with oil and gas or mineral extraction ventures but is available to other unincorporated organizations such as the [redacted] electrical power generating venture at issue herein. The ruling provides that a venture formed by four electrical power corporations in which the participants own several electrical generating units as tenants in common and each corporation has the right to and takes its share of power generated, and each corporation separately sells and distributes this power to its own customers, is classified as a partnership for federal tax purposes. Accordingly, the joint venturers may elect to be excluded from the provisions of subchapter K.

The basic holding of Rev. Rul. 68-344 has been litigated and the seminal case is Madison Gas and Electric Co. v. Commissioner, 72 T.C. 521 (1979) aff'd 633 F.2d 512 (7th Cir. 1980). In Madison, three utilities signed an operating agreement for the joint construction and operation of a nuclear plant in which electricity was distributed in proportion to their tenants-in-common ownership interests. In deciding that the joint venture was a tax partnership, the Seventh Circuit agreed with the Tax Court that the Code definition of partnership does not require joint venturers to share a single joint cash profit and that to the extent that a profit motive is required, it is met by distribution of profits in kind. 633 F.2d at 515. The court relied on Bentex Oil Corp. v. Commissioner, 20 T.C. 565 (1953) in which the Tax Court held that an unincorporated organization formed to extract oil under an operating agreement, which called for distribution of oil in kind, was a partnership and that both the Bentex and Madison joint venturers/co-owners shared the expenses of production but sold their shares of the production individually.

In summary, the Seventh Circuit found that the jointly produced electricity was distributed in direct proportion to ownership interests for resale to consumers in their service areas. The difference between market value of each share of electricity and each utility's share of production costs represented profit. The fact that profits are not realized in cash until after electricity has been channeled through the individual facilities did not negate a joint profit motive nor make the venture a mere expense sharing arrangement. 633 F.2d at 516-17.

A discussion of legislative history, S. Rep. No. 1036, 96th Cong., 2d Sess. 1, reprinted in 1980 U.S. Code Cong. & Admin. News 7293, provides pertinent background information on section 195 as implementing regulations have not been issued.

The Senate Report states that under prior law, expenses incurred prior to the establishment of a business are not deductible currently since they are not incurred in carrying on a trade or business. Expenditures made in acquiring or creating an asset which has a useful life that extends beyond the taxable year normally must be capitalized, and costs which relate to an asset with either an unlimited or indeterminate useful life may be recovered only upon a disposition or cessation of the business. Certain business organizational expenses for the formation of a corporation or partnership may be treated as deferred expenses and amortized over a period of not less than 60 months. Sections 248 and 709. Expenditures eligible for amortization are those which are directly incident to the creation of the corporation or business. Preopening or start-up expenses, such as employee training expenses, are ineligible for amortization under the business organizational expense provisions.

Start-up costs are incurred subsequent to a decision to acquire or establish a business and prior to its actual operation. Such costs may be incurred by a party who is not engaged in an existing business, or by a party with an existing business who begins a new one that is unrelated or tangentially related to the existing business. Start-up costs may include expenses relating to advertising, employee training, obtaining suppliers, or potential customers and professional services in setting up books and records.

Section 195 allows elective amortization over a period of 60 months or more of investigatory, start-up and certain active anticipatory business costs. Amortizable costs fall into 3 categories: 1) investigatory expenses incurred in seeking and reviewing prospective businesses before acquisition, 2) start-up costs of establishing a business before its actual operation and 3) for taxable years beginning after June 30, 1984, costs of any activity engaged in for profit before the active trade or business begins in anticipation of the activity becoming an active trade or business, which aren't deductible under sections 163(a), 164 and 174. Eligible expenditures under section 195

are those which would be allowable as a deduction for the taxable year in which paid or incurred if it were paid or incurred in connection with the expansion of an existing trade or business in the same field as that entered into by the taxpayer.

The amortization deduction is allowable to the taxpayer who incurs the start-up expenditures and enters the business. In the case of a partnership, the amortization deduction is to be taken into account in computing the taxable income of the partnership. In the case of qualifying investigatory expenses incurred in connection with the acquisition of a partnership interest, the amortization deduction is to be taken by the partner who incurred such expenses.

The trade or business must be entered before an amortization period can begin. The amortization period of not less than 60 months commences with the month in which a business begins.

With regard to determining when a trade or business begins, the Senate Report states that "it is anticipated that the definition of when a business begins is to be made in reference to the existing provisions for the amortization of organizational expenditures (sections 248 and 709). Generally, if the activities of the corporation have advanced to the extent necessary to establish the nature of its business operations, it will be deemed to have begun business. For example, the acquisition of operating assets which are necessary to the type of business contemplated may constitute the beginning of business." Id. at 7304. The Senate Report also notes that elections may not be made later than the time for filing the return (including extensions) for the taxable year in which the business begins and that it is anticipated that election procedures will be similar to those used under sections 248 and 709 (organization fees).

In the case of start-up expenditures paid or incurred by a partnership, an amortization election would have to be made by the partnership rather than the individual partners. Section 703(b). Any elections affecting the computation of income derived from a partnership shall be made by the partnership. Treas. Reg. § 1.703-1(b)(1). This rule, though, must be analyzed in light of the election out of subchapter K by an unincorporated organization.

I. Section 195 Election Upon Election Out of Subchapter K

Three G.C.M.'s address the issue of whether a partner may make a section 616 election if the partnership has elected exclusion from subchapter K, and they provide the background for Rev. Rul. 83-129, 1983-2 C.B. 105. We believe that the considerations underlying Rev. Rul. 83-129 are analogous to the instant issue.

Development Expenditures, G.C.M., 36982 I-244-76 (January 13, 1977) considered the issue of whether the section 616 election to defer development expenditures is to be made by the partnership or each partner when the partnership has elected to be excluded from subchapter K. Both the section 616 and section 195 elections affect the computation of taxable income derived from partnerships and, therefore, the elections, are generally made by the partnerships. Section 706(b). The G.C.M. notes, though, that section 703(b), as part of subchapter K, is not operative when the section 761 exclusion election has been made. The G.C.M. concludes that if the members of an organization make the section 761(a) election, various other elections would properly be made at the individual rather than at the organization level.

One basis for this conclusion is Treas. Reg. § 1.6031-1(b)(1)(i). This regulation provides that if an unincorporated organization elects subchapter K exclusion by filing Form 1065 in the manner required, a partnership return need not be filed for any subsequent year. If a partnership had to make the section 616 election, it would have to file a Form 1065 in subsequent years in order to make any partnership elections in those years. Furthermore, the G.C.M. points out that a taxpayer makes the section 616 election by a clear indication on the return and pursuant to Treas. Reg. § 1.6031-1(b)(1) a partnership making the section 761(a) election need file a return only to make the section 761 election. Therefore, a section 616 election is not to be made by a partnership electing out of subchapter K.

The G.C.M. also relies on Bryant v. Commissioner, 46 T.C. 848 (1966) aff'd, 399 F.2d 800 (5th Cir. 1968) in which the issue was whether a partnership or each individual partner was subject to the $50,000 limitation on the investment tax credit of section 48. The court held that when an organization has made the election to be excluded from subchapter K, it is still a partnership for purposes of section 48. Therefore, the partnership as a whole was subject to the $50,000 limitation. The court, however, also stated that sections 761(a) and 48 are not interdependent [i.e. may be applied independently; do not depend upon each other]. According to the G.C.M., this statement suggests that some provisions outside of subchapter K might be applied at the partner level if a section 761(a) election is in effect, if those provisions are dependent upon or

interdependent with § 761(a).2/

The G.C.M. concludes that if the partnership is viewed as the electing taxpayer under section 616, the adequate determination of partner income would require an examination of the partnership return to ascertain whether the election had been made. Therefore, the requirement to make the section 761(a) election that income of the members be adequately determinable without computation of partnership taxable income could not be satisfied by any partnership having the right to make a section 616 election. Accordingly, no partnership eligible to make a section 616 election could ever make the section 761(a) election.

The G.C.M. states that it is the elective nature of section 616(b) that gives rise to the type of interdependence with section 761(a), which the court found lacking with respect to section 48 in Bryant. In other words, the section 761 exclusion from subchapter K is interrelated with the section 616(b) election being made at the partner level. If such an election provision were to be applied at the partnership level, the determination of partners' incomes would depend upon reference to a partnership return, thereby creating a conflict with the requirements for a section 761(a) election. Therefore, the section 616(b) election may be made at the partner level. A nonelective limitation upon a credit or deduction such as that contained in section 48, does not create such a conflict with section 761(a) when applied at the partnership level.

In [redacted] G.C.M. 38418, I-244-76, (June 20, 1980), the Interpretative Division provided further comments on the proposed ruling which was eventually published as Rev. Rul. 83-129. The G.C.M. included the following proposed language for the revenue ruling which described the "interdependent" standard and distinguished

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2/ See Rev. Rul. 65-118, 1965-1 C.B. 30. A joint venture which elects, pursuant to section 761, not to be treated as a partnership for purposes of subchapter K, is a partnership for purposes of determining the limitation on the amount of qualified investment in used section 38 property which may be taken into account in computing the investment credit allowed by section 38. Therefore, each joint venturer is not entitled to take into account more than his allocable portion of the joint venture's $50,000 limitation on such property in computing his investment credit.

G.C.M. 36982, supra, recommended modifying Rev. Rul. 65-118, to provide an exception for code sections that are interpendent with section 761(a) as discussed by the court in Bryant v. Commissioner, supra.

Rev.Rul. 65-118:

> In contrast to the situation in Rev. Rul. 65-118 and Bryant v. Commissioner, 46 T.C. 848 (1966), aff'd, 399 F.2d 800 (5th Cir. 1968), it would be inconsistent with an election out under section 761(a) to require the partnership to make the election to defer development costs under section 616(b). If a partnership elects out, under Treas. Reg. § 1.761-2(b)(2)(i) no information as to expenditures or elections (other than the 761(a) election) is required to be included in the return filed by the partnership in the year the partnership elects out under section 761(a). Furthermore, under Treas. Reg. § 1.6031-1(b)(1)(i), the partnership is not required to file any returns in years subsequent to the year it elects out under section 761(a). Thus, the section 616(b) election must be made by the partners on their individual returns. Because the partnership has elected under 761(a) to be excluded from subchapter K, the requirement of section 703 that the section 616(b) election be made by the partnership does not apply. Consistent with Rev. Rul. 65-118 and Bryant, supra, the entity remains a partnership... for purposes of those Code provisions that specifically refer to partnerships or are otherwise not interdependent with the election out under section 761(a).

G.C.M. 39043, I-244-76 (October 5, 1983) recommended publication of Rev. Rul. 83-129 which holds that the section 616(b) election is properly made by a partner when the partnership has elected exclusion from subchapter K. The ruling, though, does not include a discussion of the interdependence standard. The G.C.M. states that perhaps it is unnecessary to get involved in explaining the concept of interdependence in the ruling.

The essence of Service position, though, as stated in the G.C.M., is that merely because a partnership elects out of subchapter K, does not mean the partnership escapes limitations applicable to partnerships if those limitations can be applied despite the fact that income and deductions are computed at the partner level rather than the partnership level. The question in each instance is whether the limitation or rule outside of subchapter K can be applied without doing violence to the concept of electing out of subchapter K and computing income and deductions at the partner level.

In summary, with regard to a section 195 election, we do not believe that such an election may be made at the partnership level without conflicting with the election out of subchapter K, even assuming the elections were made in the same taxable year.

In order to make the section 195 election, information would be required on the return which is inconsistent with the minimal information required pursuant to the election out. Also, a computation of allocations and the partnership's choice of an amortization period is inconsistent with the election out requirement that income be adequately determined without the computation of partnership income.

This view is also supported by the analysis in [redacted], O.M. 19791, I-317-83 (February 29, 1984) where the issue was whether business purpose should be determined at the partnership level or with respect to each joint venturer individually when the members of the joint venture have elected exclusion from subchapter K. The O.M. relies on the previously discussed G.C.M.'s and the Bryant interdependent test and reframes the issue as whether the business purpose test can be applied at the partnership level without doing violence to the concept of electing out of subchapter K and computing income and deductions at the partner level.

The O.M. concludes that there is a need to apply the business purpose test at both the partnership and partner levels when the partnership has elected out of subchapter K. The election out thus adds a partner level inquiry but is not inconsistent with the normal partnership level inquiry. Because of the election out, a partner's activity has two phases, the joint activity and the partner's use or disposition of the partner's share of the joint activity. The joint activity phrase could be conducted in a nonbusinesslike manner and result in the denial of deductions or only individual partners could fail the business purpose test. Similarly, although we believe the section 195 election must be made by partners, the section 195 amortization period commences with the beginning of the business, and thus an analysis of the beginning of the joint activity is also necessary.

II. Beginning of Active Trade or Business for Purposes of Section 195

Section 195(b)(1) permits amortization of start-up expenditures over a period of sixty months or more beginning with the month in which the active trade or business begins. In enacting this provision, Congress plainly recognized that the accounting concept of matching income against expenses requires that amortization deductions, like current year deductions, cannot be allowed prior to the active conduct of business. As discussed, supra, legislative history states that it is anticipated that the definition of when a business begins will be made in reference to the existing provisions in sections 248 and 709 for amortization of organizational expenses.

The provisions of Treas. Reg. §§ 1.709-2(c) and 1.248-1(a)(3) are almost identical. Both regulations make clear that organizational activities or formation are not sufficient to show the beginning of business.

Treas. Reg § 1.709-2(c) states:

> The determination of the date a partnership begins business for purposes of section 709 presents a question of fact that must be determined in each case in light of all the circumstances of the particular case. Ordinarily, a partnership begins business when it starts the business operations for which it was organized.... If the activities of the partnership have advanced to the extent necessary to establish the nature of its business operations, it will be deemed to have begun business. Accordingly, the acquisition of operating assets which are necessary to the type of business contemplated may constitute beginning business for these purposes. The term operating assets... means assets that are in a state of readiness to be placed in service within a reasonable period following their acquisition. This regulation and relevant case law will provide the basis for our analysis of when business begins for purposes of section 195.

Courts have consistently held that section 162(a) does not permit current deductions for start-up or pre-opening expenses incurred by taxpayers prior to beginning business operations. See, e.g. Aboussie v. United States, 779 F.2d 424, 428 (8th Cir. 1985). But see Hoopengarner v. Commissioner 80 T.C. 538 (1983), aff'd by unpublished order, 745 F.2d 66 (9th Cir. 1984) (Pre-operating expenses excluded from section 162 are still deductible under section 212). The Service disagrees with Hoopengarner, as do most circuits who have decided the issue.

In Richmond Television Corp. v. United States, 345 F.2d 901 (4th Cir. 1965), the seminal pre-opening expense doctrine decision, the court held that expenses for training staff incurred before the taxpayer was licensed to operate a broadcasting business were not currently deductible under section 162. In Richmond Television, the court framed the issue as the deductibility of expenses incurred between the decision to establish a business and the actual beginning of business operations. During the years at issue, taxpayer had been incorporated for the purpose of operating a television station but had not obtained a license or begun broadcasting. The court noted that the point in time of when a trade or business begins is a factual issue. The court concluded that even though a taxpayer has made a firm decision to enter a business and spent money in preparation for entering the business, a business is not being carried on until it has begun to function as a going concern and performed those activities for which it was organized. Richmond Television, therefore, began business in 1956 when it obtained an F.C.C. license and began broadcasting. Prior to that time, there was no certainty that it would obtain a license or ever go on the air. 345 F.2d at 907.

Madison Gas and Elec. Co. v. Commissioner, 72 T.C. 521 (1979), aff'd, 633 F.2d 512 (7th Cir. 1980), is a frequently cited case which involved a joint venture for construction and operation of a nuclear power plant, and thus provides many factual parallels to the [redacted] joint venturers. Three

utility companies were tenants-in-common with respect to the power plant. The court determined that various start-up costs were capital expenditures and not deductible. The case is instructive for analyzing when a trade or business begins.

Relying on Richmond Television, supra, the court held that the facts were not distinguishable and Richmond was rightly decided. In Richmond, business began when the license was issued and the station began broadcasting. In Madison, taxpayer argued that business began in 1968 when a provisional construction permit for the plant was issued by the Nuclear Regulatory Commission (NRC). The provisional construction permit provided that an operating license would be issued when a final safety analysis report was submitted, required liability insurance had been obtained and the NRC had determined that the final design satisfied all health and safety requirements. The court referred to 10 C.F.R. sec 50.50 which provides that upon completion of construction in compliance with the terms and conditions of the provisional construction permit, and subject to testing for health and safety purposes, the NRC will issue an operating license. The plant was completed and fuel loaded in 1973; the operating license was issued by the NRC on 12-21-73.

The taxable years at issue were 1969 and 1970 so the court did not have to find when business began but the clear implication in the case is that business began in 1973 when the plant was in a state of readiness for operation, and the operating license had been issued.

McManus v. Commissioner, T.C.Memo. 1987-457 and Aboussie v. United States, 779 F.2d 424 (8th Cir. 1985) involved when business began for the purposes of amortization of organizational expenses under sections 248 and 709 respectively. In McManus the taxpayer argued that the business had begun because it had received cash from investors for over 2/3 of the offered shares, expended money for manufacturing and research and development contracts and began to acquire its operating assets. The Tax Court referred to Treas. Reg. § 1.248-1(a)(3) which describes when a corporation begins business and held that the corporate activities never advanced to the extent necessary to establish the nature of its business operations. The corporation was organized to manufacture and rent out pressure instruments for use in drilling wells. Although in the year at issue, the corporation had entered contracts and begun to acquire component parts for the devices, the devices never became operational. The corporation neither tested nor rented any of the devices, and it, therefore, never acquired any of its operating assets.

In summary, relying on Richmond Television, supra, the court held that regardless of the fact that funds were expended toward the goal of entering business, the business did not function as a going concern nor perform the activities for which it was organized. It never had assets in a state of readiness to be placed in service.

In Aboussie, the partnership was formed to acquire real estate and construct and rent low income housing. A housing project was substantially completed in 1980. The court held that the partnership began business in 1980. The court reasoned that a taxpayer starts carrying on business at that time when the facts show that the taxpayer "will almost certainly engage in a profit-seeking activity." 779 F.2d at 428. In taxable year 1978, considerable uncertainty existed over whether and when the project would produce profits. Construction had begun, but the project certainly was not in a state of readiness to be placed in service within a reasonable time. The business did not function as a going concern until 1980, at which time the project was substantially completed.

As a final matter, we will consider the placed in service and commercialization date of a plant with respect to the beginning of an active trade or business under section 195.

Service position with respect to the placed in service date of power plants is that a plant must be fully operational and critical testing must be complete, although operational testing may be continuing. In addition, the plant must be under the control of taxpayer and synchronized into the main power grid and thus able to distribute power to customers. Operation at rated capacity or commercial operation is not necessary for a plant to be placed in service. See Rev. Rul. 76-428, 1976-2 C.B. 47. An operating license, of course, is granted by the NRC prior to synchronization, and synchronization is usually the event that corresponds with the placed in service date.

A placed in service and commercialization date for a power plant refers to a specific asset rather than when a trade or business begins. See e.g., Richmond Television, 345 F.2d at 909, n. 12, (the period for depreciation of an asset begins when the asset is placed in service; this answers the question of when a taxpayer who is in business may begin to depreciate an asset). Although we believe that the month a trade or business begins for purposes of section 195 and the placed in service date for a plant will be close in time, (perhaps in the same month) we believe our analysis indicates that a trade or business most likely begins prior to, rather than simultaneous with an asset's placed in service date.

When an active trade or business begins is a factual determination. The business's readiness to function as a going concern is an essential factor. McManus, supra; Aboussie, supra. With regard to the [redacted] nuclear plant, we believe that after an operating license has been issued, fuel has been loaded and the plant is in a state of readiness to be placed in service within a reasonable time, it may be determined that the business has begun, as long as no other factors indicate otherwise. This may be prior to the actual placed in service date of the plant. The state of readiness to be placed in service within a reasonable time encompasses the necessity for certainty that the plant will be placed in service. See Richmond Television 345 F.2d at 907; Aboussie 779 F.2d at 428.

With regard to the abandonment of nuclear plants, if abandonment occurs prior to plant completion, there, of course, is no dispute that business did not begin. A close question and the need for technical advice may exist if a plant is abandoned after an operating license is obtained and prior to being placed in service.

III. Limited Partners' Contributions to Capital

Limited partners are amortizing, under section 195, payments made upon request to general partners for reimbursement of various pre-operating expenses. The partnership agreements state that the general partner will be reimbursed for such expenses by the partnership. Notwithstanding our analysis that individual partners may not elect to amortize these costs under section 195, it also appears that some of the costs may be either section 709 organizational expenses or nonamortizable syndication expenses. Organizational expenses include legal fees for services incident to the organization of the partnership, such as negotiation and preparation of a partnership agreement, accounting fees for services incident to the organization of the partnership and filing fees. Syndication expenses are connected with the issuing and marketing of interests in the partnership. Treas. Reg. §§ 1.709-2(a) & (b).

Vertin v. Commissioner, T.C.Memo. 1987-161 is an analogous case where a partner was denied a deduction for fees paid to the partnership's manager. The manager's charges to the partnership were for preparation and revision of the partnership agreement and preparation of the partnership prospectus. The court held that under section 709(a) no deduction is allowed for organization and syndication fees. Furthermore, organization fees may, at the election of the partnership, be amortized over a period of not less than 60 months. Section 709(b). The partnership made no such election. See also Driggs v. Commissioner, 87 T.C. 759, 777-78 (1986) (Fees paid GP are nondeductible organization and syndication costs).

In the instant case limited partners are claiming deductions for section 195 costs which are amortizable solely at the election of the partnership. A similar mischaracterization existed in Egolf v. Commissioner, 87 T.C. 34 (1986). A general partner was denied a deduction for expenses which were incurred by him as an agent of the partnership, and received from the partnership as reimbursement for organization and syndication expenses. The partnership agreement was structured in an attempt to avoid the strictures of section 709. Instead of the partnership directly bearing nondeductible capital costs of organization and syndication, the agreement required the general partner to bear the costs. The partnership then reimbursed the general partner for the organization and syndication costs with a management fee, for which the partnership claimed a current deduction. 87 T.C. at 42. The court held that the general partner was acting as a partner when he incurred the

organization and syndication costs on behalf of the partnership. Therefore, neither the partner nor the partnership could receive a current deduction for the costs. Similarly, we believe the payments made by the limited partners in the instant case are investments by the limited partners, and based on the partnership agreement, are received by the general partners as reimbursements from the partnerships.

Accordingly, we are in agreement with the conclusions of the Atlanta District on this issue. The expenses at issue are partnership expenses; the limited partner is an investor and is not engaged in the business activity. To the extent the expenses are section 195 start-up costs, they are amortizable at the election of the partnership, not individual partners. The expenses are not investigatory expenses of individual partners which may be amortized under section 195 when incurred with regard to the acquisition of a partnership interest.

In conclusion, the expenses belong to the partnership and may only be amortized pursuant to section 195 upon the election of the partnership. The payments by limited partners are capital contributions or investments in the partnership.

If you have any further questions, please contact Joyce C. Albro at 566-3521.

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